

SECTION 3: IC INQUIRY

**INDUSTRY COMMISSION INQUIRY - TOBACCO
GROWING AND MANUFACTURING INDUSTRIES :
A SUBMISSION BY PHILIP MORRIS LIMITED**

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February 11, 1994



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PHILIP MORRIS INDUSTRY COMMISSION SUBMISSION : DRAFT 6/2/94

1. Introduction

Philip Morris' makes this submission to the Industry Commission as it prepares to consider the appropriate structures within which the tobacco industry will operate after the termination in 1995 of the Tobacco Industry Stabilisation Plan (TISP) and the Local Leaf Content Scheme (LLCS).

This submission is presented on behalf of Philip Morris Limited, a wholly owned subsidiary of Philip Morris (Australia) Limited. Philip Morris is a unit of the \$US61 billion Philip Morris Group of Companies, the world's largest consumer packaged goods company, also including Kraft Foods, Jacobs Suchard and Miller Brewing.

We have endeavoured to answer in detail all matters raised by the Commission in its Terms of Reference and Issues Paper issued in November, 1993 and also provided information to the Commission when it inspected the Philip Morris Moorabbin plant.

While not raised by the Commission in its Terms of Reference or Issues Paper, we have addressed our concerns at the effect of GATT tariffication on government policy on protection for the tobacco industry (see *Section 12*).

We note the Commission is to report to the government within 9 months, and we look forward to further assisting the Commission at the hearings to be held at a later date.

1.1 The Philip Morris Company

Philip Morris Limited, as Australia's largest tobacco manufacturing and marketing company, has a primary interest in the continuing development of a viable and internationally competitive Australian tobacco products manufacturing, marketing and tobacco growing industry after 30 September, 1995 when TISP and the LLCS will be terminated by the Federal Government.

***CHECK** Philip Morris in Australia is a significant economic entity in its own right, with
REV FIG. - annual revenue of \$839 million, employing 1200 people, paying salaries and
BB wages of \$58.4 million, and benefitting other industry sectors by buying an
estimated \$220 million worth of goods and services each year.

The company has achieved export earnings growth in the three years 1990 to 1993 of 67.5% and in 1993 our earnings were \$33.7 million. There is considerable potential for the export of larger quantities of cigarettes from Australia. Conversely, without an increase in exports, coupled with a further decline in cigarette consumption, there could be disinvestment, rather than

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investment, by the tobacco manufacturers and growers in Australia. It is important to note that Australian exported cigarettes would be replacing poorer quality, existing forms of tobacco products which have higher levels of tar and nicotine, and include cigarettes such as Kretek and Biddies, chewing tobacco and snuff, which fall well short of the standards achieved by Philip Morris under rigorous quality control management.

We discuss in more detail in another part of this submission, the potential for greater export earnings over coming years, given much needed grower focus on leaf quality improvement, price and grading post 1995, and, strong government support and encouragement for export development.

The Philip Morris tobacco company has made a concerted effort, particularly over the past two years, to bring the benefits to Australian growers of its US company's agronomic research and development program. Through the Philip Morris "*Partners in Quality Program*" we work with growers on bringing Australian leaf quality up to international standards. Through LLCS to the Tobacco Research and Development Council we contribute more than \$100,000 annually, with a further \$50,000 invested directly in industry research and development.

We are committed to the long-term viability of our Australian manufacturing and marketing operation, and will continue to work with all parties to ensure a viable tobacco growing industry post-1995, to a large extent reliant on a consistent improvement in the quality of locally grown tobacco leaf, price competitiveness and supply consistency. Other improvements are needed in growing methods, productivity and efficiency gains, and an enhanced international marketing focus post deregulation to ensure a viable industry over the long-term.

Since the last industry inquiry in 1987, there has been little overall change in local leaf quality. Further improvement is vital if Australian leaf is to remain as a competitive input to local cigarette product alongside leaf from other countries. The industry has to compete in an international marketplace without the current protection and assistance afforded by TISP and LLCS. We see no benefit in phasing down tariff protection, preferring quick changes to an open and free market, with the withdrawal of the LLCS providing the necessary impetus for leaf quality improvements.

2. Market Trends

The Commission invites advice on perceptions of emerging trends in the domestic and global markets for tobacco and tobacco products, the factors which influence production, consumption and trade flows, and likely future developments.

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2.1 Leaf production

Current worldwide tobacco leaf production is estimated at 7.3 billion kilos (USDA statistics for 1992).

***FIGS** Major producers are identified in *Fig. 4*, with associated consumption data and leaf stocks in *Fig. 5*.

***FIGS** Detailed information on total tobacco and flue-cured tobacco production is in *Figs 6* and *7*, with specific details of volume, areas and farm values for the years 1987/1991 in *Fig. 8*.

The farm-gate value of worldwide leaf production is difficult to ascertain because of exchange rate movements and reported statistics are not always reliable. However, the following estimates (USDA 1993) show farm-gate values, and volumes, for leaf (of all types) produced by some countries in 1993:

	Producer	Volume (kilos)	Farm-Gate Value (\$US green/kg)
*RE-CHECK NOS.	China	3.3 billion	60-70c
	USA	660 million	3.65
	Brazil	509 million	1.22
	India	518 million	1.00
	Zimbabwe	201 million	1.35

In 1993, Australia's leaf crop produced 12.5m kilos at an estimated farm-gate value of \$A6.14 (\$US4.175 @ 0.68) per kg, with a forecasted 8.1m kgs in 1994 at an estimated \$A6.03kg (\$US4.10).

2.2 Leaf Consumption

The major tobacco leaf *consuming* countries are China, India, the United States, India, the countries of the European Common Market (EEC), Japan, Brazil and Indonesia. Large volumes of leaf are used by some countries, although they are not necessarily heavily involved in world *trade* of the leaf because they grow domestically for their own use.

The major international *exporters* of tobacco leaf are Brazil, USA, Zimbabwe, Greece, Malawi, Turkey and Italy.

Brazil, the USA and Zimbabwe are the main exporters of flue cured tobacco. The EEC countries are the major leaf consumers, buying all types of tobacco (flue cured, burley and oriental) worldwide from all major trading countries. The USA, the Russian Federation, Japan, European Free Trade Association, Egypt and China are all important *importers*, with the former Communist Bloc taking some leaf and China smaller volumes.

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2.3 Tobacco Products Consumption

Fig. 9 shows cigarette production in selected countries, including products consumed both domestically and exported, *Fig. 10* details cigarette export and import figures and *Fig. 11* identifies cigarette production trends in specific countries.

The consumption of made up tobacco products (primarily cigarettes), in general terms, has declined in the major western countries, including North America, Europe and Australia.

In the rest of the world, generally classified as the underdeveloped countries (i.e. China, India and Indonesia) consumption has grown as per capita wealth increases, with the greater usage of machine-made cigarettes, rather than hand-made or locally made products. There has been an accompanying decline in the nicotine and tar delivery due to the greater degree of technology and manufacturing consistency applied by international manufacturers, and a significant factor in ensuring consumers in these countries gain access to a far better quality product.

Consumption has declined noticeably as a result of fiscal policies in some countries (e.g. Brazil), but the general trend is upwards.

In developed Asian countries (i.e. Japan, Singapore) there has also been a general increase in the consumption of tobacco products, although not as marked as increases in the under-developed countries. The increased domestic consumption trends in the still developing countries are estimated at 1 to 1.5%, with decreased consumption levels in Western nations showing 2% in the US and 1 to 1.5% in Europe.

***CHART/
TABLE
REQ'D -
OVER
WHAT
PERIOD?** In Australia, tobacco products consumption has declined by 10 to 12%.

International trends forecast a continuing, modest increase in world consumption of tobacco over the next 5 to 10 years, with overall world consumption increasing, particularly in developing countries with some offset in specific countries due to taxation and health-related measures.

As the former Communist Bloc countries and underdeveloped nations gain increasing wealth and disposable income, cigarette consumption is forecast to increase, particularly of machine manufactured cigarettes of international specifications to replace those locally made tobacco products of vastly inferior quality.

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Consumption is expected to grow in the Asia-Pacific countries, although there may be tax and health-related pressures. Consumption in China, especially, is expected to grow as the market opens to international tobacco products. Indonesia, with increasing wealth, is expected to move away from Kretek and locally made products to international-style, machine-made cigarettes.

As international companies progressively trade in new and expanding markets, there will be pressure on local tobacco and tobacco products manufacturers to move to international product standards and improve their own quality.

The relaxation of tariff and other barriers is expected to result in increased trade opportunities for international cigarette brands in the Asia-Pacific, with regional growth in consumption around 2% annually.

2.4 Future Leaf Supply/Demands

There was an international supply excess of tobacco leaf (not made up products) over demand in 1993, a situation likely to continue in 1994-95, and possibly 1996, driving leaf production significantly down in the major producing countries such as the US, Brazil and Zimbabwe. A reduction in supply and a move towards supply/demand balance is expected in 1996.

The underlying international usage trend, however, is still around 6.5 billion kilos for raw tobacco. Modest increases are forecast to 1997 and beyond.

In Australia (given that manufacturers maintain usage at around 57%) demand for all leaf is expected to decline between 2 and 5% over the next 3 to 4 years, bringing domestic leaf usage to around 9.5 and 10.5 million kgs dry weight per annum from the current ____ kgs.

*INSERT
NO.

Imports will follow a similar overall trend, but the proportion used could be significantly impacted by developments in the domestic leaf producing industry.

3. Structure and Competitiveness

The Commission seeks to examine the current structure and competitiveness of the industries, drawing international comparisons where appropriate. Requests include:

- *What influence has the existing assistance and adjustment arrangements had on the structure of these industries?*
- *How does Australian tobacco growing compare internationally, with respect to price, input costs, farm size, and quality of tobacco grades?*

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- *How do Australian tobacco products compare internationally in terms of price, input costs, quality of product?*
- *Why are some products imported, while others are exported from Australia?*
- *What characteristics differentiate the imports and exports and make them competitive in their respective markets?*

3.1 Leaf Production, Quality, Prices, International Competitiveness

The current stabilisation program, through the local user scheme, has effectively provided growers with tariff protection. Australian manufacturers are encouraged, through the duty system, to use above a certain level of domestic tobacco.

Local growers enjoy a stronger price negotiating position because manufacturers pay less duty on imported tobacco if they use a certain proportion of domestic. However, while manufacturers effectively have some incentive to use domestic tobacco, there is a negative effect on local growers who are less world competitive on price and quality.

The base duty level on imported tobacco is about \$A1.42 cents per kilo, but because of the price offset for greater use of domestic tobacco (currently 57%) the effective rate of duty on imported tobacco averages approximately 25 cents a kilo for leaf from recognised developing countries.

Manufacturers would have a greater incentive to use a higher percentage of Australian tobacco if quality was comparable to competing international product, and local tobacco was competitive with world prices. The ability to select only the required grades, and to operate as freely in the domestic market as in the international market, would also be a significant influence.

International leaf prices declined significantly in 1992 and 1993 while Australian prices remained high. With world prices expected to decline yet again in 1994, Australian prices will be significantly overpriced in 1994 and 1995.

Australian growers have a major challenge, particularly in the post-1995 deregulation period, when their current average quality of tobacco leaf could be overpriced, in world terms, by as much as 25 to 30%.

***INSERT** *Fig. 12 indicates the movement of the industry submitted import distribution price movements between 1990 and 1993, realised average prices for Australian tobaccos and projections to 1996.*
SOURCE

This indicates a low ISP target for growers to achieve by 1996. To insulate both manufacturers and growers against movements in world prices, it would

be appropriate to take an average, for the period 1990/1993 inclusive, of 453.1 cents per kilo.

With quality improvement, growers have the potential to improve returns above this level, perhaps to \$A5.00 per kilo. Improvements in quality, productivity, efficiency, production costs and crop management generally would assist in overcoming the price disadvantages of Australian growers.

Industry inventory and adjustment costs (not changes in the base usage level) agreed under the stabilisation program, mean that production volumes of the Australian crop will decline from 12.5 million kilos in 1993 to 8.1 million kilos in 1994, potentially remaining depressed in 1995, with foreseen "recovery" to usage levels until 1996.

The industry has agreed an inventory target by 1 January 1996 equivalent to 10 months of projected use.

The base usage rate in 1994 is likely to be something in excess of 10 million kilos dry weight and, even though the market may continue to shrink into 1995, base usage should remain close to 10 million kilos dry weight, with a situation foreseen in 1996 where base usage, provided all manufacturers continue to use 57%, could be around 9.7 to 9.8 million kilos.

From a manufacturer's perspective, the industry will be driven by the competitive position of the Australian growers, with quality versus price a key determinant.

Quality is absolutely critical. If there was a dramatic improvement in the quality of Australian leaf, Philip Morris envisages a much higher probability of manufacturers maintaining, or increasing, domestic tobacco purchases.

Conversely, if quality does not improve significantly, or indeed deteriorates, it is unlikely domestic tobacco will be competitive, bringing pressure on manufacturers to question the continued use of 57% domestic leaf in an unprotected environment. There is every potential that domestic leaf usage would decline, especially if it is not competitive on quality and price.

***INSERT** *Fig. 13 shows selected historical data comparing prices and production levels*
SOURCE of major flue cured tobacco categories and countries.

The Commission will be aware that Australian growers currently produce what has been commonly referred to as filler tobacco at the lower end of the quality scale. The highest quality classification is fully aromatic, currently only produced in the US, and the middle quality classification semi-aromatic, of which Brazil, Zimbabwe and Malawi are the major producers.

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The potential for Australian growers to be competitive is significantly diminished if they continue to produce tobaccos in the lower priced, filler end of the market.

The best interests of growers lie with raising quality to the semi-aromatic sector where the prices for the product are higher. Current international prices for filler return to growers somewhere between 50 and 60 cents (\$US) a kilo at farm gate, or even less. Australian growers cannot produce to meet a sale price of 50 to 60 cents.

However, in the quality markets - say the semi-aromatic classification - growers trading internationally are receiving \$US2.50 (\$A3.68) to \$3.00 (\$A\$4.0) green. Given our current level of farm input costs, the potential for Australian growers to compete internationally is enhanced if they produce a higher quality with returns equivalent to these levels, and allowing for import substitution cost consideration.

This is a reasonable and achievable objective, but only if there is a total revamp of cultural practices, with greater emphasis on quality rather than the current emphasis on yield. Input and production costs will also have to be closely controlled.

There will be potential to open up international markets for Australian produced leaf if quality is moved to the semi-aromatic level. While it would be a tough competitive environment in which to operate, that is an objective that all manufacturers, and the good growers, would like to achieve.

***COMMENT** Comparing international leaf, it is important to note that Australian tobacco
J SCOTT: delivers its own taste profile. With the removal of the LLCS, and if
CONTRA- Australian manufacturers moved to less than 57% domestic leaf usage, the
DICTIONARY? distinctive taste profile would probably dictate a phase-out period, perhaps over two to three years, rather than a sudden change to other leaf sources.

Traditionally, all manufacturers are very cautious in introducing changes to their products which can result in negative consumer reaction.

A minimum 50% Australian leaf usage by manufacturers is required to be commercially viable. If content drops significantly below 50% the industry would progressively wind-back below the critical mass required to support the processing and marketing infrastructures. Therefore, quality improvement remains the key consideration for maintenance of leaf usage levels.

Australian leaf quality is also adversely affected by its imbalance of chemical constituents (*Fig. 14*) and the lamina/stem ratio of leaf produced (*Figs 15 and 16*).

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If leaf quality improves there is the potential for usage in excess of 57% content in the longer-term, although probably not on a run-of-crop basis, but with manufacturers detailing preferred grades. Trading terms would need to also reflect the world situation.

3.2 Local Tobacco Products International Competitiveness, Quality

Current domestic cigarette manufacture accounts for approximately 98% of locally consumed products. Only an extremely small proportion of imported product is consumed.

*BEARDMORE
TO CONFIRM
NUMBERS Of the total Australian cigarette market of 30 plus billion sticks annually, only approximately 1.9%, or about 600 million, are imported product.

*CHECK FOR
NUMBERS Imports are primarily at the extreme luxury end of the market with very specialist taste profiles. Hand-rolled products, pipe tobacco and cigars have a significantly higher share of imported product.

If Australia is to compete in the global, manufactured cigarette market, or even just regionally in the Asia-Pacific market, taste profile is of major importance.

If significant proportions of Australian tobacco as currently produced, are used, we would expect problems. Australian tobacco does not have the taste profile, or even the chemical performance, to allow it to be competitive with other internationally produced Virginia cigarettes now sold in the Asian market.

If quality improves, there is the potential for Australian tobacco to be more readily used in Australian manufactured export products.

Cigarettes are currently exported from Australia using a significant proportion of Australian leaf, but sales volumes are extremely small. However, the balance of trade on manufactured product is now in Australia's favour by about 3 to 1, with nett exports currently in excess of imports at around

*INSERT NOS. _____ sticks exported annually.

4. Exports

The Commission requires information on the extent of exports of Australian leaf and tobacco products, the countries which constitute the major markets for exports, and the competitors in those markets.

In addition, the Commission asks if different health standards or labelling requirements in different countries affect exports and, if so, how?; what costs are involved in producing different labelling for the exported, manufactured tobacco product?; there was a recent example of one manufacturer exporting tobacco leaf, after treating it with its own specially developed technology. Could this treatment be

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used more extensively to make Australian tobacco leaf more attractive to overseas buyers, or was this a 'one-off' sale?

The Commission is asked to report on the potential for further development of the industries, including the scope for increasing exports while, at the same time, taking account of Australia's international approach in relation to tobacco and health?

What are the barriers to the export of tobacco leaf and tobacco products?; subject to Australia's international approach in relation to tobacco and health, what is the scope for further developing the industries, including increasing exports of both leaf and manufactured products and given that the TISP and LLCS will terminate in September 1995?; is Australia's international approach to health and tobacco a barrier to export development?

4.1 Leaf Export Levels, Potential Markets

There have been very limited exports of Australian leaf. The 250 tonnes purchased from Australian growers in 1993 was largely to satisfy a one-off sale by Philip Morris of semi-processed product to one Asian country.

There is only limited potential for leaf exports in the true filler market, the category currently produced in Australia. Other lower priced countries readily undercut Australia in the international filler leaf market, and will continue to do so due to significantly lower production costs.

The mid-level, semi-aromatic market is the level for Australia to compete in (see also *Section 3.2*). A commitment to consistent quality upgrading across the Australian crop is required, and even then sales potential may not be realised in this very competitive market. Leaf purchasing decisions would be made on a strict commercial basis, with consideration of tobacco requirements including smoking quality, chemical constituents and long-term supply of paramount importance.

Philip Morris' own international leaf buyers in the US and Europe have previously commented unfavourably on Australian standard leaf grades. On both a quality and value/price basis Australian leaf was nowhere near competitive.

4.2 Health Standards/Labelling Standards for Exports

If quality standards are met, we would not expect the health standards and labelling requirements in other countries to be a major issue affecting entry of those products into export markets, although manufacturers could incur higher manufacturing costs per pack to meet labelling specification for different countries.

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If Australian growers continue to produce tobacco with relatively high nicotine content that could exclude them from potential sales in specific markets. To correct the problem, local growers have to use less nitrogen, grow crops faster, grow in the right season, and acquire a greater level of market awareness and understanding of the end-users of their product.

4.3 Special Export Treatment

The special treatment in 1993 of an export shipment of tobacco leaf was a one-off deal by Philip Morris (this information is *confidential* to Philip Morris) and does not represent any ongoing opportunity to build further export business by utilisation of this method.

4.4 Barriers to Tobacco Leaf and Tobacco Products Exports

Australian leaf quality and price are still the main barriers to competing internationally, as outlined in some detail. The other potential barrier is the lack of international marketing expertise amongst Australian growers, who need to become more market focussed to succeed in selling leaf internationally where they would be competing with highly qualified dealers. Growers would be best advised to have those established dealers act on their behalf on a commission basis.

4.5 Trade Marks

*INFO. FROM ERIC/LEGAL

5. Factors Affecting Efficiency and Structure/Arrangements Affecting Supply

The Commission invites comment on how the removal of the local content and stabilisation plans and related programs will impact on individual participants in the industry. Elements of the assistance schemes where there may have been impact include marketing quotas; limitations on the transfer of quota; leaf and grade price schedules; allocation rather than competitive bidding for leaf; export assistance; funding of research and development; subsidised irrigation water in some areas.

The Commission suggested that since the inception of TISP and the LLCS, modifications have been made in order to encourage greater efficiency and to gradually reduce the level of assistance to the tobacco growing industry - ie barriers to quota transfers have been virtually eliminated; attempts have been made to reduce the size of manufacturers' leaf stockholdings; prices for leaf have been set to gradually bring them closer to the import parity price.

5.1 Marketing Quota System

With the inter and intra state transfer system broken down, the marketing quota system is much freer. Unfortunately, farmers are still growing tobacco

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which is not necessarily of the quality demanded by the market. Whilst these growers may still be viable as a very small unit, they may not be viable in international terms on price and/or quality, most specifically quality.

5.2 Leaf and Grade Price Schedule

The leaf and grade price schedule has had a negative impact on the industry by not, in effect, rewarding those areas that reflect manufacturers' demands, for example:

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MEANING

- Few price levels have resulted in "insensitivity" (price gaps too wide)
- Emphasis on colour has been misleading
- Grade/price structure has rewarded production of tonnes/hectares, not quality
- No recognition, or delayed recognition, of the importance of maturity/texture/oiliness of leaf
- Grower refusal to accept change, reinforced by TISP/LLCS
- Research effort (especially North Queensland) has focused on exploiting grade/price schedules, with no attempt to reflect buyer interests

The industry arbitration procedures are totally negative, serving only to create conflict between growers and buyers and, most important, protecting poor growers and not rewarding good growers.

The current system is a legacy of history, with undue emphasis on leaf colour, and insufficient emphasis on maturity, ripeness and texture of tobacco.

There is industry agreement to introduce an international classification system for the 1994 and 1995 crops, to run in parallel with the current system, and to form the foundation for the post-deregulation environment. We are concerned this is only a two-year time frame for growers to become comfortable with the new system and no pricing has yet been established against the new grading system.

While the new, international classification system will introduce an emphasis on leaf maturity, ripeness and texture, we suspect that in 1994, and perhaps even 1995, pricing will still be based on the old grading system.

Agreement has been reached for the price schedule to expand to 24 groups in 1994, with a review post-season 1994. The proposed move to individual grade pricing, post deregulation, is essential if growers are to receive the correct market signals.

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Pricing should also be related to the new international classification system as rapidly as possible, preferably before deregulation, with prices rewarding production of styles required by manufacturers. Growers should be penalised where necessary.

5.3 Allocation Versus Competitive Bidding

The Commission seeks comment on allocation rather than competitive bidding for leaf.

The industry has examined a range of alternative marketing systems:

- National Australian Growers entity, trading with manufacturers either as one body or individually
- State grower entities, trading as one
- Open auctions
- Direct contract negotiation between each manufacturer separately, and with individuals/grower groups

Philip Morris has no specific preference for any one option. However, a system of direct negotiation by each manufacturer is likely to be the least efficient and least cost-effective. The company is prepared to participate in any system which is legal, equitable and maintains continuity of supply of a quality product at a commercially competitive price.

On the question of allocation versus competitive bidding, Philip Morris recognises that the latter allows an element of selectivity, and affords any given buyer the opportunity to reward leaf favoured for purchase. With only three buyers at auction, there may be insufficient competition to sustain a true auction system.

Allocation does ensure equity amongst all buyers. There may be problems however, if buyers do not distribute their off-take on a pro-rata basis between States, even though this may reflect buyer preferences.

5.4 Export Assistance/R&D

In terms of export assistance, the key area of focus has been funding of research and development, with government contributing half a percent of the gross value of product (green leaf).

Growers and manufacturers have made an equal contribution to R&D, equivalent, in total, to 5.4 cents a kilo.

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Research and development funding will effectively decrease in coming years because of lower volumes and revenues. Measures to deal with the decreases in funding and research are being handled by the Tobacco Research and Development Council (TRDC), of which a Philip Morris employee is a member. The TRDC is considering ways, whereby the decreased funds can be best spent to assist in quality improvement and reduced leaf production costs.

Philip Morris, on its own initiative, has provided company funds for promoting research and development in the growing area, over-and-above the required contribution under the current assistance scheme.

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1994?
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DATES?

Philip Morris has invested approximately \$115,000 in 1993 and a projected \$80,000 (1994 ??) as the company's mandatory 2.7 cents per kilo contribution. In addition, the company has contributed in excess of \$50,000 through its own program.

There have been three visits in the past two years to Australia of Philip Morris US experts on growing and technology. Philip Morris hosted Victorian, Queensland and New South Wales growers on visits to the US in 1992 and 1993 to study growing methods and the application of the latest technology.

Philip Morris leaf experts at the Moorabbin plant in Victoria have continued to reinforce with local growers, the lessons learnt from the US visits, with our own initiatives quite successful in fuelling the process of change, particularly in Victoria, and to a lesser extent in Queensland and New South Wales. We will complement the work of the TRDC by allocating further funds in 1994 to host additional US study visits by Australian growers, and to ensure the continued transfer of the latest techniques and technologies. Maintenance of current R&D budgets of the TRDC will start to bring flow-through benefits to the industry.

5.5 Subsidised Irrigation Water

Water supply for irrigation purposes in the tobacco growing areas is plentiful, but pricing by local authorities is not facilitating growers to a better competitive position in world markets. This is an issue for negotiation between growers and local water authorities.

6. Tobacco Growing

The Commission invites comment on the effects that the latest TISP and LLCS have had on production, quality of leaf and prices.

- *How have growers been affected by recent changes : ability to sell quotas throughout the country; attempts to reduce the size of the stockholdings; movement towards import price parity and reduction in the aggregate quota?*

Other questions posed by the Commission, include:

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- *Has the experience of growers with these changes been a guide to further adjustment in the future?*
- *What role did changes to the local content and stabilisation plans play in reducing the gap between Australia and international prices for tobacco leaf?*
- *Does the administered grade and pricing system cause the prices received for the various grades to differ from those which would be realised in a more open market environment?*
- *Has the quality of Australian leaf improved and, if so, why has this occurred?*
- *As a consequence of the trade of quotas, how has the volume and value of production changed between regions?*
- *What are the reasons for this change?*
- *Are there other changes which have impacted on growers?*
- *When tobacco manufacturing receives tariff-only assistance, what will be the implications for domestic growers?*
- *How will growers determine how much they will grow?*
- *Is there likely to be a further shift from one growing area to another?*

6.1 TISP Affects

There has been a negative, long-term impact on the leaf growing industry from the protection afforded growers through TISP.

TISP has not served to improve the quality of Australian tobacco, and prices, which in an indexed form, have gone down over time since the system was introduced, are still not internationally competitive.

Tobacco quality has not improved because, through TISP, the incentive has been to improve yields instead of quality. As the industry moves into a deregulated market, there will be more incentive to improve quality.

In a more open market environment, the current administered grade and pricing system will not assist the change process. If the new, international system is embraced by the industry it has the potential to assist growers move to a competitive, world market position. Growers' own costs of production, the farm-input costs, is still an issue for them, but, as a market incentive, the new system would be far more reflective of the world market.

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6.2 Quotas, Tariff Protection

Trade in quotas has mainly been north from South Queensland and New South Wales to North Queensland, with transfers primarily driven by the structure of the old grade and price schedule, and bringing with it the problems highlighted elsewhere in this submission. The decline in South Queensland has largely been driven by local economic and infrastructure changes. *Fig. 17* details quota movements for the period 1978 to 1992.

***CHECK
SCOTT -
DO WE
WANT TO
SO BLUNT?** The move of quotas from New South Wales has broadly been correct as quality of tobaccos from this area is generally inferior, and not world competitive. There is no long-term, viable future for tobacco production in NSW.

***CHECK
WHEN?** The moves from South Queensland to North Queensland appeared logical at the time, but, as more and more tobaccos are grown in the tropical winter of North Queensland, with inferior smoking quality, we question if these moves have been as beneficial as first appeared.

Tariff levels after 1995 will be key to the international competitive position of Australian tobacco growers. Lower tariffs mean Australian growers will have to be far more competitive on quality - a desirable outcome for Philip Morris, and consumers.

If growers continue to benefit from tariff protection it will be important for manufacturers to have a similar level of protection applied to imported manufactured products. Without this balanced protection, the sale of imported products containing no Australian leaf could expand to the detriment of both Australian growers and manufacturers, their employees and businesses serving the industry.

6.3 Marketing Systems

The industry has important decisions to make on the appropriate marketing systems for a deregulated market. Radical change will occur as the industry is restructured and different arrangements are established between growers and manufacturers.

In a free market environment, it is likely that manufacturers nationally would table their leaf needs, and it would be up to the growers, negotiating between themselves, to decide who gets what. Eventually, a situation is envisaged where a manufacturer may choose, at any time, to buy tobacco from one state and not another. That would be a radical change in the industry, but entirely consistent with the government's stated objective of a deregulated, fully competitive industry.

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With this outcome, consideration would need to be given to a phase-down period, or an immediate change in 1996.

We believe growers, subject to the requirements of the Trade Practices Commission, are keen to maintain many of the current mechanisms in the marketing system, with as little change as possible.

Philip Morris is seeking only to buy tobacco at the right price and quality level through an efficient marketing system. The alternative systems are, as already indicated, via national or state trading entities dealing with manufacturers, an auction system, or contract growing where manufacturers have direct contracts with individual farmers or co-operatives.

With a system of co-operatives, it is envisaged a manufacturer may choose to deal with, say 65 growers, all of whom may be in Victoria or Queensland. This would prejudice other growers.

Manufacturers' decisions on which growers to deal with would have to be made on the basis of the price and quality of a particular crop resulting in a highly competitive, internationally aligned market. Prices would come down. Quality would go up.

A market operating this way would have no standard pricing nationally, or on a State basis. Instead, separate pricing systems would operate between manufacturer and grower, based on the manufacturer's own crop value assessments.

The areas growing the best tobacco at the same price as the world market would clearly have a better opportunity for sales under this system.

6.4 Grower Production Costs

The basic cost of tobacco production in Australia is a fundamental issue to be addressed by growers. Given tobacco quality can be raised to that of other producing countries, such as Brazil and Zimbabwe, Australian growers would still be disadvantaged because of lower production costs in these other countries. Exchange rates in these countries are manipulated to some extent, to keep local industry competitive in many products, including tobacco. However, those countries are only able to sell their tobacco for a certain value, so their conversion costs are not necessarily below Australia.

Potential cost reductions for Australian growers may be achieved through a lower use of fertilisers, especially nitrogen, benefitting leaf quality and chemistry.

A shortening of the growing period and time in the field should also reduce costs for chemicals (i.e. insecticides and herbicides), reduce management costs

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and improve quality. With curing costs potentially reduced through faster curing, energy costs would come down.

Improved growing techniques should be further considered, with assistance through the research and development mechanisms to study the good techniques used in countries like the United States.

7. Tobacco Manufacturing

The Commission seeks information on how tobacco manufacturers have responded to the most recent TISP and LLCS.

- *Does the administered price scheme distort production decisions?*
- *Does the selling system result in either lower quality leaf or a less than optimal mix of grade and type of leaf?*
- *How important are price and quality of local leaf in domestic manufacturers' decisions to use local leaf?*

Other recent changes for tobacco manufacturing include the decline in local demand for tobacco products and increases in excise taxes.

- *What are the main reasons why demand for tobacco products has declined?*
- *To what extent is the decline in demand due to government intervention?*
- *After termination of the TISP and LLCS, will manufacturers be able to selectively purchase leaf and generally have more control over their mix of quality and type of leaf?*
- *Although, in terms of months of usage, the stockholding of manufacturers has not been reduced, will this be achieved in the future?*
- *If not, what circumstances might prevent it?*
- *What level of stockholding would be observed in the absence of any agreement/requirement to hold a minimum level?*

7.1 Manufacturer Responses

In response to TISP and LLCS, Philip Morris and other manufacturers have tried to introduce a process of change through the entire system, so that, with deregulation and the right pricing systems in place, growers will know what quantity and quality crops to grow, and how they will be rewarded according to an assessment system, as outlined elsewhere.

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7.2 Production Distortions

The administered price scheme distorts production decisions because the pricing mechanisms have not reflected real demand on the world market, where focus on quality is paramount.

To some extent this has reduced manufacturers' flexibility to manage their blends because a major component (57%) is basically the same.

7.3 Selling System Affects on Leaf Quality

As stated previously, the selling and pricing systems have not sent the correct signals to growers about the quality of leaf required.

7.4 Manufacturing Decisions on Leaf Usage

Through TISP and LLCS, there is currently an incentive for manufacturers to use local leaf. However, without TISP and LLCS and a free market operating, price and quality, will be absolutely dominant in manufacturers' decision-making on local leaf usage, subject to tariff levels.

The actual usage and content of Australian domestic leaf may vary up and down, depending on the year, and other factors. Manufacturers are reluctant to dramatically change their blends in a short time frame because of issues such as taste profiles. While manufacturers would not want to introduce change in tobacco content too quickly, change could, nevertheless, be introduced far more quickly than is perhaps appreciated.

7.5 Decline in Product Demand, Tax Increases

***BB - CHECK NOS.** In the 10 years prior to 1991, consumption of cigarettes in Australia had been growing, in absolute terms, at a rate of 0.1%.

***INSERT NOS.** Since 1991, consumption has declined by __%, almost entirely attributed to the economic conditions prevailing in Australia.

The compounding affects of the reduction of disposable income during the recession, and significant increases in tobacco products State taxes (i.e. 186% NSW, 150% QLD) and Federal excise (23%) have driven the volume reduction in the 1991-93 period.

Specifically, price rises cause low outcomes. The "shock" of price rises result in short-term volume declines, which later bounce back to reveal the more underlying decline rate, which is not significant.

***DOUBLE CHECK BB - ARE WE** Therefore, the effect tax increases have on consumption is somewhat dependant on prevailing economic conditions.

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PROVIDING
MORE
SUPPORTING
DATA??

7.6 Selectivity of Leaf Purchase

There will be no change, at this stage, in the selectivity of leaf purchase, with broad industry agreement currently on purchasing run of crop. The situation, may change, depending on what marketing models finally emerge with deregulation, an improvement in quality and the potential for import substitution if prices are competitive.

7.7 Inventory

Philip Morris' tobacco stockholdings are currently well over the agreed industry target of 10 months stock by 1 January 1996. We have not progressed as rapidly as expected in reducing stockholdings, although steps are being taken to correct the previous oversupply position. Crop production levels envisaged for 1994 will continue to address this issue.

To further reduce stockholdings, manufacturers should be free to indicate their requirements without the application of an industry-wide formula, as is the case now, and be able to manage inventories as they wish. Although this could mean some greater volatility in demand, manufacturers would be willing to give demand indications for, say, a three year horizon, providing growers with the opportunity to plan investment and production, and make appropriate adjustments.

8. Policies Affecting Tobacco Consumption (Production/Industry Efficiency Related)

The Commission comments that, while policies affecting consumption can, in general, be considered separately from assistance to production, some may have an impact on the efficiency and performance of the industries. An example of such a policy is the agreement by Federal and State Health Ministers, at a meeting in July of this year, to implement new labelling requirements which will result in warnings occupying 25 per cent of the front of a packet of cigarettes.

What effect, if any, will these particular changes have on manufacturing costs and on demand?; do differences in State licence fees impact, in any way, on production decisions. If so, how?

How much of the manufacturers' tobacco needs are expected to be sourced locally after the removal of the local content scheme?; are there advantages to manufacturers from using local leaf that offset any price disadvantages. If so, what are these?

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8.1 New Labelling Affects on Production

Production costs will increase if manufacturers are required to produce different labels for State markets with differing regulatory requirements, a position currently faced (see detailed comments *Section 10.4*).

8.2 Sourcing Local Leaf

The level of local leaf used will depend on quality, prices and consumer preferences. The advantages of use of local leaf are, potentially, consistency of supply, lower inventory levels than for imported tobaccos (shorter delay in shipping finished product), reduced exposure to fluctuations in exchange rates, and the ability to influence more directly the types of leaf produced.

8.3 State License Fees

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9. Arrangements Between Growers and Manufacturers

If the market was completely deregulated, how would the growers and manufacturers respond?; would agreements as to the type and quality of leaf, and their prices, be made between growers and manufacturers. If so, what form would these agreements take?

Now the government has decided to discontinue the TISP and LLCS, the setting of the minimum price and grade schedule and conditions attached to sale should no longer apply. Will this be so, or are alternative arrangements envisaged.

What alternative selling arrangements would growers want to put in place. Would they need approval of the Trade Practices Commission?

What role are the State Tobacco Leaf Marketing Boards expected to have after 1995?; how are the powers of the State Boards and their position with regard to the Trade Practices Act likely to change after 1995?

9.1 Selling Schemes/TPC and State Board Roles

The options for alternative selling schemes and arrangements between manufacturers and growers have substantially been answered in *Section 5*.

We acknowledge the Trade Practices Commission has emphasised that competition be maintained in the growing and manufacturing sectors, and that the quota system of production be deregulated.

We see no particular role for State Boards post deregulation, given introduction of a market-driven structure.

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10. Policies Affecting Consumption (Consumer, Taxation, Social Costs Related, etc)

The Commission states it is required to take account of the economic, social, health and environmental objectives of governments. The following policies are primarily directed at health and public safety concerns associated with tobacco products:

- prohibitions on smoking in certain locations*
- prohibitions on the sale of tobacco to minors*
- prohibitions on advertising*
- segregation of smokers from non-smokers*
- labelling requirements for specific health warnings*
- publicly funded anti-smoking campaigns*
- child education programs, and*
- voluntary limit put on tar, nicotine and carbon monoxide content, developed in agreement with the department of health*

The Commission asks, what effects have the health and public safety interventions had on the consumption of tobacco products in aggregate?; are measures, such as bans on smoking in particular locations, more effective than taxation in dealing with problems such as passive smoking?

It is in the consumption area that claims are made that market outcomes need correcting. Arguments put forward to justify government intervention include that smoking is an environmental carcinogen, that nicotine is a toxin, and that teenagers are too young and impressionable to make decisions about smoking which are in their long-term best interest. Much of the government intervention on the consumption side is justified on the grounds of trying to correct for the negative effects that tobacco has, or is perceived to have, on health.

In addressing the question of Federal and State Government objectives with respect to tobacco and health, the Commission notes that Ministers of these governments, through the MCDS (Ministerial Council on Drug Strategy) unanimously agreed on the need for clearer, stronger warnings to discourage people from smoking, and especially to stop children taking it up.

The Commission asks: Does this adequately reflect the attitudes of all governments to smoking, or is it more complex than this?; participants may wish to comment on the reasons why they think that market outcomes are not desirable and could be improved with government intervention; are the current policies and programs

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designed to effect consumption the most effective means of achieving the health and other objectives of governments, or could improvements be made?

With respect to health, the Commission has been asked to take account of Australia's international approach to tobacco and health. Australia's international position is relevant to the export potential of the industries and has a direct effect on production, rather than consumption, within Australia.

10.1 Passive Smoking (ETS), Workplace, Public Place Restrictions

The Commission poses the premise that Environmental Tobacco Smoke (ETS), often referred to as "passive smoking", is a proven health risk, a position which Philip Morris rejects, and which is not supported by a body of scientific and other evidence internationally.

Passive smoking is a far more complex issue than state and federal governments, and their instrumentalities, have acknowledged in providing justification for the implementation of various policy initiatives. The Commission itself, in its Issues Paper, says: "does this (government policies) adequately reflect the attitudes of all governments to smoking, or is it more complex than this?"

It is generally accepted that good public policy depends on (i) compelling, convincing evidence of the highest quality, and (ii) rational, clear and coherent use of that evidence to make public policy decisions.

In the instance of "*prohibitions of smoking in certain locations*" and "*segregation of smokers from non-smokers*", Philip Morris submits that there is a lack of compelling, convincing scientific evidence to support initiatives by Australian governments, whether it be to protect non-smokers from "*an environmental carcinogen*" or to "*discourage people from smoking*".

Available scientific evidence does not persuasively support such policies if (as it appears) these policies are based on an alleged risk of chronic disease related to ETS exposure. In the absence of such support, Philip Morris suggests to the Commission that it is impossible to make coherent public policy decisions of the sort currently under consideration.

As noted in the Commission's Issues Paper, the government's justification for imposing, or suggesting smoking bans or restrictions, is based upon the contention that it is a proven "*environmental carcinogen*".

World-wide data, including eminent scientific/medical evidence, fails to prove that environmental tobacco smoke/ETS or so-called "*passive smoking*" causes cancer, heart disease or other chronic diseases sometimes attributed to ETS exposure. Much of the evidence supports the proposition that ETS is not even statistically associated with these diseases:

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- To date, 35 published studies have examined whether being married to a smoker increases one's risk for lung cancer. 29 of these 35 (i.e. 83%) report no statistically significant increased risk or a decreased risk of lung cancer.
- 14 studies have examined whether workplace ETS exposure increases one's risk for lung cancer. 12 of these 14 report no statistically significant association.
- 6 studies have examined ETS exposure in social settings, which report 10 different risk estimates for lung cancer. 9 of these estimates report no statistical significant association. The other reports a significant decreased risk of lung cancer.

A distinct minority of studies examining ETS/lung cancer (less than 15%) is portrayed by anti-smoking advocates as demonstrating that there is a small increased risk of lung cancer (in the range of 19%, they say) "between 35 and 53%. By precisely the same reasoning, it can be said that other studies demonstrate that keeping pet birds increases the risk of lung cancer by 570%, that high dietary saturated fat increases the risk by 500%, cooking with peanut or rapeseed oil increases the risk by 170% and frequent consumption of whole milk increases the risk by 100%. Yes, statistically studies support each of these propositions, yet no-one is calling for a ban on whole milk or pet birds.

The extreme weakness of the arguments supporting the claims that passive smoking is a significant contributor to chronic health diseases, has been noted by eminent scientific and medical commentators.

*INSERT
REF/APP

With regard to lung cancer, Peter Lee's (need ref. to who he is and appendix note) text entitled "*Environmental Tobacco Smoke & Mortality*" (1992) reviewed the studies pertaining to the topic and concluded:

"Considered in its entirety, the epidemiological evidence does not convincingly demonstrate that exposure to ETS increases risk of lung cancer among non-smokers".

*INSERT
REF

In 1993, Dr Armitage (ref. to who he is and Ref. No.) published an article in the Journal of Smoking-Related Disease entitled "*Environmental Tobacco Smoke and Coronary Heart Disease (1993)*", in which he concluded:

"The case for ETS exposure causing CHD (coronary heart disease) is wholly unconvincing because almost all of the accepted 'causational' criteria remain unsatisfied. Note: In the meantime, it is wrong that an ETS/CHD health scare has been blown up out of all proportion in the last few years by a passionate anti-ETS health lobby. Interpretative

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opinions are not proven facts; they must be challenged and a more balanced point of view presented to the general public."

*F/NOTE 3 The fact is the phrase "*passive smoking*" is misleading. It suggests that a non-smoker is exposed to the same thing as a smoker. This simply is not the case.^(1,2) Environmental Tobacco Smoke (ETS) is very different from the smoke a smoker inhales. It is a hundred times more dilute and it undergoes extensive chemical and physical changes before it reaches non-smokers.⁽³⁾ To compare ETS with a smoker's smoke is like comparing apples and oranges.

*F/NOTES 3,4,5,6 In addition, virtually all of the substances known to be present in ETS are present in the air from other sources (such as office equipment, building materials, cleaning solvents and furnishings). Scientific studies indicated that non-ETS sources release the majority of these substances into indoor air.^(3,4,5,6)

Because ETS is visible and easy to identify, it is frequently blamed for poor indoor air quality. However, scientific studies have concluded that inadequate ventilation is most often the real culprit. If there is a build up of smoke in the air, which indicates poor ventilation, then there is also a build up of other substances from non-smoking related sources.

Many studies from around the world report that ETS is typically a minor contributor to poor indoor air quality. For example, both US government and private studies on "Sick Building Syndrome" have reported that ETS is a direct factor in only 2-5% of the complaints in building investigated.^(4,5,7,8) In contrast, more than half of the complaints in buildings investigated were traced to inadequate ventilation.

*F/NOTE 3 Indeed, scientists have had a major problem in measuring ETS in real-world settings because most chemical components of ETS are also produced by many other sources unconnected with smoking and also because many of the chemical components in ETS are present in such minute quantities that they are difficult to detect.⁽³⁾

Nonetheless, nicotine in the air is often used as a marker for non-smoker exposure to ETS with the results presented in terms of "*cigarette equivalents*" as a means of illustration.

*F/NOTE 18,14 The results of several recent studies have shown that to be exposed to the nicotine equivalent of one cigarette, a non-smoker would have to dine for 300 hours in a restaurant permitting smoking,⁽¹⁸⁾ or 100 hours in a tavern/bar.⁽¹⁴⁾

*F/NOTES 7,8,9
*F/NOTE 10 It has been estimated that, in a workplace permitting smoking, it would take between 260 and 1,000 hours for a non-smoking worker to be exposed to the nicotine equivalent of a single cigarette.^(7,8,9) In other words, that worker would be exposed to between 2 and 7 cigarette equivalents during the course of an entire work year.⁽¹⁰⁾

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*F/NOTES
6,15,16 Other scientific and technical research has demonstrated that proper ventilation, when adequately maintained, can drastically reduce the minuscule exposure levels referred to above.^(6,15,16)

*CHECK
REF NOS We commend the Commission to submissions made by Healthy Buildings International (HBI) (Ref. No. _____) and BESCA (Ref. No. _____), in which they express the opinion that existing ventilation and filtration systems, if properly maintained, are also invariably sufficient to provide accommodation for both smokers and non-smokers; separate ventilation is not necessary to provide adequate indoor air quality for non-smoking and smoking areas; and, the rush to institute smoking restrictions or bans *"misunderstand or ignores scientific, technological and medical information available concerning interaction between ventilation/filtration and ETS"*.

Philip Morris is in full agreement with an industry view that the less restrictive alternatives of ventilation and segregation must be carefully considered before legislation imposing smoking restrictions/bans can be justified, if at all.

However, in Canberra, ACT Health has proposed (1993) government-mandated smoking bans, despite the fact that, in the highest levels of science, there is disagreement as to whether exposure to ETS causes chronic disease in non-smokers.

Three noteworthy examples of so-called *"authoritative opinion"* used by ACT Health to support their proposals for smoking bans, are:

1. National Health & Medical Research Council Report on Passive Smoking (1986)

*CHECK APP. The NH&MRC stated in 1986 that it *"acknowledges that further research is necessary to confirm and elaborate these effects of passive smoking on health."* (Page 45 of Report, Appendix ..??..). The *"effects"* referred to are the *"inferences"* that NH&MRC was willing to draw on equivocal and inconclusive evidence.

As the NH&MRC is currently reviewing its 1986 research, it would be most prudent for to await the outcome of that review before further actions to attempt to bring in mandated smoking restrictions.

2. International Agency for Research on Cancer

ACT Health and others have claimed that the IARC listed *"tobacco smoke"* as a group 1 carcinogen, and that smoking should be banned in workplaces as a result. However, a careful review of the 1986 monograph published by the IARC makes it clear that this body was making reference to *active* smoking, not ETS or passive smoking.

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We would suggest to the Commission, that for ACT Health, or any other body, to rely on the IARC paper to support public policy in relation to smoking restrictions to overcome alleged ETS or passive smoking problems, is patently wrong and should be ignored.

3. United States Environmental Protection Agency Risk Assessment on ETS
*CHECK APP. (Appendix ..??..) released 1993.

The risk assessment made by the EPA has been criticised by many eminent scientists, who have noted for example that the EPA based its risk assessment of lung cancer on only 11 of the 13 U.S. epidemiological studies available.

The two studies excluded were those by Stockwell⁽⁹⁾ and Brownson⁽¹⁰⁾. The EPA chose to exclude these studies because they were published after the arbitrary cut-off date in 1992. Both reported no increased risk for overall exposure to spousal smoking. It is noteworthy that the Brownson study is the largest study published on spousal smoking status and lung cancer in the US and was sponsored by the National Cancer Institute.

When the results of these studies are added to the EPA's meta-analysis, the combined result is not statistically significant at the accepted 95% confidence level, or for that matter on the less rigorous 90% standard applied by EPA.

- *CHECK REF Alvan Feinstein, Professor of Medicine and Epidemiology at Yale Medical School wrote recently (reference ..??..) in Toxicological Pathology that the EPA study on ETS *"simply ignored the inconvenient results and emphasised those that are helpful."* Professor Feinstein observed that government agencies funding scientific research often become *"mechanisms of advocacy."*

- *CHECK ATT Further significant criticisms made of the EPA risk assessment are detailed in the attached paper "Smoke and Mirrors" : The EPA's Flawed Study of Environmental Tobacco Smoke and Lung Cancer" Huber et al, 1993 (attachment ..??..). Among their criticisms, Huber et al noted:

"In its report on ETS, the EPA did not comply with accepted principles of toxicology, chemistry, and epidemiology, nor with its own guidelines for undertaking cancer risk assessment".

So little respected is the EPA Risk Assessment that the United States Occupational Safety and Health Administration has commissioned its own review of ETS to determine whether smoking in the workplace ought to be restricted. That is, it has specifically determined not to rely on the EPA report. This may be due to the congressional investigations of EPA

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practices, and the EPA's lack of scientific method and objectivity as widely reported in the press.

As other authorities in the US have questioned the validity, or not relied upon, the EPA report, so, too, should the Commission and other Australian authorities not rely on it. In the absence of such support, it is impossible to make coherent public policy decisions of the sort currently under consideration.

With regard to the question of whether ETS causes health risks in public places, we draw the Commissions' attention to the most recent legal case concerning "*passive smoking*" in a public place, the Burswood Resort Casino (WA) case, which should cause government bodies to question whether smoking bans or restrictions can legitimately be justified on public health grounds.

It is significant, in the Burswood case, that the Department of Occupational Health, Safety & Welfare was unsuccessful in its prosecution of the Burswood Casino, despite the fact that there were found to be moderate levels of ETS present in the casino.

The department alleged that casino employees were at a health risk from respiratory illness, impairment or reduced lung function due to ETS exposure.

In dismissing the claim against the casino, the court stated"

"Whilst ETS is annoying, and of discomfort to non-smokers, it has not been proved at the required standard, or at all, in this prosecution, that it is a risk to the health of the employees at the casino."

(Reasons for Judgement, page 9, 1993).

*NEED TITLE/REF In more general terms, the late Dr Allan Crawford (NEED TO REFER TO WHO HE IS ETC?? questioned, in his paper, whether ETS exposure posed any health risks sufficient to warrant governmental imposition of smoking restrictions. In his paper, entitled "*Environmental Tobacco*
*APP. *Smoke in the Workplace*" (appendix note), he concluded:

"From a scientific standpoint, the rush to promulgate workplace smoking restrictions is astonishing when one considers what the existing research shows" (page 127 Dr Crawford's paper), and

"Government officials reviewing workplace smoking restriction proposals should beware the limited and inconclusive nature of the data concerning the asserted long-term health consequences of exposure to ETS in the workplace, and the growing body of data

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indicating that actual exposure levels are minute" (page 131 Dr Crawford's paper).

Debate on passive smoking/ETS will clearly continue. It is important for those concerned with the issue, including governments and their instrumentalities, to give proper consideration to the arguments, put forward by many authoritative sources in Australia and internationally, about indoor air quality and ventilation as a key factor for focus when considering the passive smoking/ETS issue.

Smokers and non-smokers alike are entitled to adequate indoor quality through proper ventilation and filtration. Banning smoking may remove the indicator, but not the cause, of indoor air problems and Philip Morris rejects the illusory "*quick fix*" of banning smoking to solve indoor air problems. Nevertheless, some people find ETS annoying, which is why we encourage smokers to smoke with courtesy and common sense. We firmly believe that in any environment, both smokers and non-smokers can and should be accommodated.

10.2 Prohibitions on Sale of Tobacco to Minors

Philip Morris does not want children to smoke and actively works to discourage smoking by young people and to limit their access to tobacco products. Smoking is an adult custom and they should be free to make an informed decision whether or not to smoke. We market only to adults, not to children.

We have successfully lobbied most State and Territory governments to increase from 16 to 18 years the legal age of selling tobacco to minors.

We do not want those under the legal purchasing age to smoke and have implemented a national "*It's The Law*" campaign to encourage compliance with the law by retailers, and indeed young people.

In October 1993, the Philip Morris funded campaign was launched to 40,000 retailers, reminding them about the law and encouraging them to obey it. A kit supplied to retailers included information in respective State laws, posters and decals for display in retail outlets. In late December 1993, we commenced distribution to retailers in Victoria and South Australia of buttons "*It's The Law - It's Illegal To Sell Cigarettes To Under 18s*", coinciding with the commencement of new laws on the age limit for purchasing cigarettes. The Philip Morris salesforce has reinforced the campaign objective with retailers and they continue to encourage compliance with the law.

While it is not Philip Morris' role to act as a policeman in helping to stamp out tobacco sales to minors, we support the use of laws to keep cigarettes out of their hands, and to penalise retailers knowingly breaking the law.

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We acknowledge that limiting access to the purchase of cigarettes is only one step in a number of initiatives needed to discourage smoking by young people, with a continuing focus on education campaigns aimed at the young a high priority for governments, with the active involvement of companies like Philip Morris.

We are, therefore, currently considering development of a consumer campaign, focussed upon initiatives for education and training to counteract peer pressure motivation and similar factors which are acknowledged (see *Section 10.5 - Prohibitions on Advertising*) as a major contributor to the problem of underage smoking.

10.3 Publicly Funded Anti-Smoking Campaigns

The activities of publicly funded organisations which oppose the tobacco industry, and continue to take up substantial resources using taxpayers funds, should be given greater scrutiny by government.

The State health promotion foundations, financed using hypothecated funds raised by tobacco sales' levies, have wide ranging charters to improve the health of the communities in the States in which they operate. Their charters include:

- funding health promotion advertising to replace tobacco advertising and sponsorship;
- supporting sports and arts' activities related to promotion of good health; and
- funding research related to health.

Philip Morris does not suggest public funds should not be devoted to promoting and improving community health, sport or the arts. However, we do question the hypothecation method of funding which as Price Waterhouse ^(Insert No.) said, in a 1991 study *of health promotion foundations in Australia, "... hypothecation reduces the ability of governments to adopt a flexible approach to budgetary priorities and impedes the effective and efficient allocation of government outlays".* The ways in which the foundations are funded, and operate, Price Waterhouse maintained, *"... also raise scope for community attention to issues of good budget management, accountability and equity", and "... the evidence to support the contention that removal of tobacco sponsorship of sport and arts will reduce the number of smokers and the incidence of smoking is, at present, inconclusive".*

Further, criticising funding methods, Price Waterhouse said, *"It appears both illogical and inequitable to establish foundations which have a charter to*

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promote a wide range of health and safety messages and to place the burden on one section of the community only - tobacco users".

There have been other reports and assessments of health promotion foundations.

*INSERT
F/NOTE NO. In one report, "*A Considerable Success*": An Economic Evaluation of the Victorian Health Promotion Foundation by Professor Neville Norman (1992)^(Insert F/Note No.) commissioned by VHPF itself, a cost-benefit analysis of the Vic. Health is made, and broadly concludes:

- After five years of operation (1987-1992), the VHPF has been a considerable success
- On an extremely conservative estimate, the \$121 million investment has returned more than \$200 million in 1990 values and prices from the Quit campaign alone

The Norman report then broadly recommends:

- That the economic return justifies both the maintenance of the hypothecation system and substantial increases in the tobacco levy
- That a significant share of this increase be accorded to the VHPF
- That the '*efficiency*' notion be used more extensively in evaluating the use of funds for major recipients

*INSERT
F/NOTE
NO. ?? Price Waterhouse ("*A Question of Balance, Oct 1993*")^(Insert F/Note No.) commissioned by Philip Morris), evaluated the Norman Report and concluded:

- The underlying analysis (by Norman) of mortality rates, benefits and application of a discount rate cannot support the conclusion that the Victorian Health Promotion Foundation (VHPF) is a success; and
- As no comparison is made against other potential uses of the funds applied to the VHPF, and no data is supplied on the internal efficiency or otherwise of the VHPF, an argument for an increase in funding for the VHPF cannot be sustained. Hypothecation itself is in direct opposition to this type of comparative analysis.

The Price Waterhouse review was an extensive assessment of the health promotion foundations, and Philip Morris commends it as an important and balanced contribution to the study of the tobacco industry as the Commission considers publicly funded anti-smoking campaigns and policies intended to modify smoking behaviour.

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10.4 Labelling Requirements for Specific Health Warnings

The Commission notes that Federal and State Governments, through the MCDS, have agreed on the need for clearer, stronger warnings to discourage people from smoking, especially to stop children taking it up.

There is neither data, nor logic, to support labelling recommended by the MCDS. The proposal to appropriate more than 50% of the cigarette package is based upon the assumptions that young people⁽¹⁾ do not know of the reported health risks of smoking and⁽²⁾ modified warnings covering most of the package will somehow stop youth smoking. It is uniformly recognised, however, that peer pressure, not lack of knowledge or awareness, is the primary influence on youth smoking and that there is universal awareness in Australia on the reported adverse affects of smoking on health.

In a 1993 study, ANOP Research Services Pty Ltd found that of adults (20 years and over) surveyed, 96% were aware of reported health risks and 100% of young people (15-19 years) were aware. The study surveyed 2,062 geographically representative Australians and 99.7% of all respondents nominated health risks associated with smoking in response to a series of three open-ended questions. A copy of the ANOP survey is appended.

In the public policy debate on the proposed new labelling and health warnings, politics has played an increasing part, with the debate emanating from an April 1992 MCDS decision to introduce new State based regulations requiring new and strong warnings. This included a requirement that the entire back of cigarette packets be taken up with prescribed warnings. (See attached *examples.*)

*INCLUDE
E.G.s IN
APPENDIX

At the time of the July 1993 MCDS, Western Australia was the only State to have gazetted regulations, and these had already been amended significantly.

On September 28, 1993, Victorian Government gazetted labelling regulations, consistent with European standards and requiring stronger and larger warnings. The following day the Federal Health Minister announced he would use Trade Practices Regulations to override the new Victorian regulations and achieve national uniformity. In December, the ACT Government enacted labelling legislation consistent with the MCDS proposal but different from Victorian Regulations. Also in December 1993, the WA Government gazetted new regulations which are gazetted differently from those previously gazetted and amended, consistent with the MCDS proposal, but different in some aspects from the ACT legislation and of course different from the Victorian Regulations.

At the end of January 1994, manufacturers are faced with a serious dilemma: how to manufacture for a single national market within which 3 different sets of regulations come into effect on different dates and may be overridden in the

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foreseeable future by a fourth set of regulations, different again from those currently in place.

The minimum implementation period required by manufacturers to comply with Government mandated labelling requirements is 12 months. This time-frame has been explained in great detail to Governments, but its significance for industry has been largely ignored.

The Victorian Regulations provided a 12 month implementation period, ACT 4 months and WA 6 months. Government officials have argued that manufacturers have known for over 12 months that new labelling will be required and therefore should be in a position to implement new regulations less than 12 months after their gazetting. However, it is unreasonable to expect compliance with any proposals until they become law, or unless there has been mutual agreement that the proposed labels are reasonably necessary and the time-frame practically achievable.

If regulations are to continue to be effective in controlling certain practices across a whole range of business activities, then manufacturers cannot be expected and certainly should not be obliged to make expensive business decisions on what they think the regulations might require. Such decisions can only be made in a climate of certainty. It is unacceptable for a business alleged to be in breach of regulation to plead ignorance of them.

Similarly, it would be financially irresponsible of businesses to spend money on changing manufacturing processes on the basis of regulatory changes foreshadowed in ministerial press releases.

10.5 Prohibitions on Advertising

*F/NOTE

"There is little evidence that advertising results in additional smoking, as with many products, cigarette advertising mainly shifts consumers among brands". U.S. President's Council of Economic Advisors.⁽¹⁾

The contention that tobacco advertising influences people to smoke overlooks the function of advertising in a "mature" product market; such as the market for cigarettes, toothpaste, laundry detergent or cars.

In a "mature" market, where the product category is long established and awareness of the product is universal, advertising does not generally operate to increase overall demand. Advertising instead, operates to maintain or expand market share within the product category..... to maintain the loyalty of consumers who already use the brand being advertised and to switch consumers who use other brands. Cigarettes are a long established product and awareness of cigarettes is in fact so wide spread that they are the very model of a "mature" product category.

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The aim and effect of advertising for such "mature" product categories is to promote, and to provide information on, particular brands of the product, not to promote the product category itself. Many studies have found that advertising in such markets is not significantly related to aggregate product demand.⁽²⁾

*F/NOTE

Thus, denying product information to consumers (which effectively limits competition) will not effect broad consumer demand patterns. Government policies which aim to reduce smoking prevalence by instituting advertising bans are therefore extremely unlikely to have any impact.⁽³⁾

*F/NOTE

The fact is that, in "mature" markets, advertising and consumption are unrelated, thus there is no relation between smoking incidence - in juveniles or adults - and advertising restrictions. Indeed, numerous studies indicate that consumption is declining in many countries where advertising is allowed, while increasing in countries where it is prohibited.^(3,4,5,6,7)

*F/NOTE

For example, in Finland, where tobacco product advertising has been banned since 1978, a 1991 study published in the Finnish Medical Gazette⁽¹⁶⁾ reported that smoking increased in Finland until 1976, two years before tobacco product advertising was banned. Then,

"The consumption of tobacco products and smoking among young people started to fall. However, in the mid 1980's the figures once more started to rise, and on the basis of the situation of the early 1990's, smoking does not appear to be decreasing at the moment".

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Tobacco product advertising has been banned in Norway since 1975, yet a study by Gotestam et al published in the Journal of Norwegian Medical Association, 1990⁽⁸⁾, reported that *"The total incidence of daily smoking among Norwegian adults (defined as persons 15 years of age and older) remained essentially unchanged between 1979 (38%) and 1989 (36%)".*⁽⁸⁾

In 1992 when further assessing the hypothesis that an advertising ban leads to reduced tobacco sale and to reduced smoking in Norway, Gotestam et al concluded, *"The results supported neither hypothesis"*, and that *"The enacted legislation does not seem to have affected either tobacco sale or the number of regular smokers in Norway"*.⁽¹⁷⁾

*F/NOTE

Consistent with this conclusion, a team of anti-tobacco researchers told the 7th World Conference on Tobacco and Health in 1991:⁽¹⁰⁾

*F/NOTE

"Although Norway, in many respects, has been a pioneer in the campaign against tobacco, the prevalence of smoking in Norway has changed very little in the past eight years. The prevalence of daily smoking among men was reduced from 52% in 1973-1974 to 40% in 1981. This

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percentage has remained nearly constant since then. Among women, the prevalence rate of regular smoking has been constant, about 32 - 33% since 1973 "During the period when the prevalence of regular smoking was constant in Norway, the prevalence of regular smoking in the USA was reduced by between $\frac{1}{3}$ and $\frac{1}{4}$ ".

*F/NOTE Major cross country studies disclose similar findings. A 16 - country study of eight Soviet Bloc and eight Free-Market countries⁽¹⁸⁾ disclosed that smoking increased.... sharply in some cases.... between 1970 and 1984 in the Soviet Bloc countries, even though advertising did not exist during this period.

*F/NOTE In the eight Free-Market countries, included in the study, consumption was not substantially affected by tobacco product advertising bans or strict controls. In Italy for example, where advertising was banned in 1962, adult per capita consumption increased from a base of 100 in 1960 to 182 in 1984, and in Iceland where advertising was banned in 1971, per capita consumption increased from a base of 100 in 1971 to 113 in 1984.⁽¹⁸⁾

In Eastern European countries, data from the World Health Organisation (19) indicate that sales of cigarettes rose between 4 and 22 per cent from 1975 to 1989 even though cigarette advertising was not allowed.

*F/NOTE As with adult smoking incidence, surveys on smoking trends among young people in countries where cigarette advertising has been banned or severely restricted, have found that these decisions have been ineffective in reducing smoking among their young people.^(8,9,10) If advertising were a significant influence on smoking among juveniles, one would expect juvenile smoking to be higher where tobacco advertising is permitted than where it is not. But a

*F/NOTE WHO survey⁽¹¹⁾ found "*no systematic differences*" between juvenile smoking in countries where tobacco advertising is banned and in those countries where it is not. Indeed the WHO survey and three Children's Research UNIT studies

*F/NOTE ⁽¹²⁾ disclose that the incidence of smoking among young people is higher in many countries where advertising is banned than where it is not.

Those in favour of banning or restricting tobacco product advertising assert that such advertising not only influences adult smokers to continue smoking, but that it also causes children and teenagers to decide to smoke. In fact, available evidence indicates that advertising is among the least influential factors involved.

*F/NOTE In an update focusing on the prevalence of youth smoking among school children in 1986-1987, Aaro and two colleagues reaffirmed the results of an earlier study.⁽²⁵⁾ They found, in general, that the countries with the highest incidence of youth smoking are those in which tobacco advertising is banned, while the countries with the lowest incidence of youth smoking are those in which some tobacco advertising is permitted.

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In both Finland and Norway, where tobacco advertising has been banned for more than a decade, Aaro and his colleagues found that in Finland 29 percent of the 15-16 year old boys and 20 percent of the 15-16 year old girls were daily smokers in 1986-1987; while in Norway 16 percent of the 15-16 year old boys and 17 percent of the 15-16 year old girls were daily smokers in 1986-1987.

In both Austria and Switzerland, by contrast, tobacco advertising is permitted, Aaro et al noted that:

"In Austria 12 percent of the 15-16 year old boys and 13 percent of the 15-16 year old girls were daily smokers in 1986-87, and in Switzerland 10 percent of the 15-16 year old boys and 12 percent of the 15-16 year old girls were daily smokers in 1986-1987.

*F/NOTE Significantly, in Hong Kong a government sponsored study⁽²⁷⁾, no children mentioned advertising as a reason for smoking. The Hong Kong study confirms that parents and peer group appear to be the most significant influences on youth smoking.

In Singapore, where tobacco product advertising has been banned since 1970, the Health Ministry claims that smoking among 15-19 year old boys jumped from 5.5. percent in 1987 to 12.3 percent in 1991, and that smoking among 15-19 years old girls increased during the same period from 0.1 percent to 0.7

*F/NOTE percent.⁽²⁸⁾

*F/NOTE A "Special Report on the Impact of Tobacco Advertising" published in the International Journal of Advertising in 1990⁽²⁶⁾ reiterates these conclusions:

"Cross-national studies on smoking indicate that the prevalence of smoking is high in countries with an almost complete ban on tobacco advertising (Australia, Canada, Norway and Sweden) and low in countries with a more liberal advertising climate (Argentina, Hong Kong, Japan, Kenya, and the Philippines). This indicates that any reinforcing and justifying effect of advertising does not cause adolescents to start smoking".

*F/NOTE So far as young people are concerned, the most forceful determinants of smoking are parents, peers and older siblings^(13,14,15), and before launching their attack on cigarette advertising, anti-smoking advocates and government researchers appeared to acknowledge that these factors are the primary influences on smoking by young people.

*F/NOTE • In 1983, Dr. Mortimer Lipsett, the Director of the US National Institute of Child Health and Human Development, testified that *"The most forceful determinants of smoking (by young people) are parents, peers, and older siblings"*.⁽²⁰⁾ Dr. Lipsett also noted:

- *"If one parent smokes, the child is twice as likely to smoke as one reared in a non smoking household. If both parents or one parent and an older sibling smoke, the chances become four to one. If the child's best friend smokes, there is a 90 percent probability that the child will smoke too".⁽²¹⁾*
- *F/NOTE

Researchers looking at the long-term correlation of factors provide further support for the thesis that peers are the most dominant influence in youth smoking.⁽²²⁾ These findings reflect a world-wide phenomenon and are not limited to the United States.

*F/NOTE

- The Swedish National Smoking and Health Association concluded in 1983 that *"the smoking habits of young people are dependent on the smoking habits of their parents"*.⁽²³⁾
- *F/NOTE

- Monique Begin, then Canada's Minister of National Health and Welfare, stressed in a 1983 address that *"The people who most influence a child to start smoking are his or her friends and family"*.⁽²⁴⁾
- *F/NOTE

The decisive influence of family and peers on youth smoking is again supported by a four-country survey conducted in 1983-84 by the World Health Organisation (WHO), the results of which were published in 1986.⁽¹¹⁾

*F/NOTE

"When young people start smoking, the most important predictor is the smoking behaviour and smoking related activities of significant others".

The WHO survey further reported that *"The strongest statistical relationships are found with the smoking habits of the best friend"*. The survey also found that smoking among school children is *"strongly related to the number of smokers in the family"*, and found *"no systematic differences"* between the smoking behaviour of young people in countries where tobacco advertising is completely banned and in countries where it is not.

Particularly instructive is the testimony in 1986 before the House Subcommittee on Health and the Environment by Dr. Roger D. Blackwell, Professor of Marketing at Ohio State University, and Dr. Scott Ward, Professor of Marketing at The Wharton School, University of Pennsylvania.

*F/NOTE

⁽²⁹⁾ Dr. Blackwell explained that:

"From his parents a child acquires basic attitudes toward smoking. The more the parents smoke, the more likely the child will smoke; the more the parents discourage smoking the less likely the child will smoke".

"Friends also play a significant role in the youngster's decision to try smoking and become a smoker. And so does the image of the smoker that most children develop. Children report a distinct image of the

stereotypical smoker, and it is not the flattering image that anti-tobacco advocates attribute to cigarette advertising".

"The stereotypical smoker is viewed by children as less educationally successful, less healthy, and 'tougher' than the stereotypical non-smoker, and non-smokers generally view other non smokers as more desirable to have as friends than smokers".

"None of the research suggests that advertising influences children to view smoking in a positive light, we are talking about not intent but actual response among the children. To the contrary, the research that is available revealed in young people a scepticism and distaste for cigarette advertising".

Given the demonstrated role that parents and other role models play in smoking by young people and the absence of evidence that advertising has any significant effect in this regard, there is no reason to believe that banning cigarette advertising would lead to reduced smoking among young people.

Clearly, three factors flow from these various studies, (a) there is no evidence to support the view that a ban on advertising would have a positive effect on smoking habits, (b) no empirical research has been able to show that tobacco products advertising leads to greater tobacco consumption, and (c) there is no evidence to suggest that advertising entices non-smokers, particularly young people, into becoming smokers.

Philip Morris believes therefore that its opinion that advertising does not promote the uptake of smoking is fully supported. Thus the virtually total bans applying in Australia to the advertising of tobacco products, are both unsupportable and unreasonable constraints on the company's ability to communicate with smokers; and impose unnecessary commercial constraints on the company's ability to market its products in an intensely competitive market. Products which are, in fact, legal to produce and consume.

The same holds true for bans imposed on tobacco company sponsorship which do not in fact constitute advertisements.

11. Current Assistance to Growing and Manufacturing/Removing Impediments and Economy-Wide Efficiency

The Commission is to quantify the extent of any assistance provided to the industries and consider recommendations which will be directed at determining appropriate tariff assistance to put in place following cessation of existing arrangements for the industries, along with identifying ways of making the industries and the economy more efficient.

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